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Supreme Court of the United States

OCTOBER TERM—1926.

THE EQUITABLE TRUST COMPANY OF NEW YORK as Trustee in Bankruptcy of Knauth, Nachod & Kuhne,

Petitioner,

against

THE FIRST NATIONAL BANK OF TRINIDAD, COLORADO,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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The case presents for determination the rights of the parties to an international banking and exchange transaction of a kind conducted daily in great number in the financial centers of the country and involving millions of dollars yearly. The Trinidad Bank claim is similar to approximately two hundred and twenty claims filed by other banks and bankers in the bankruptcy proceeding and involving approximately $850,000. It is hoped that the determination of this claim will make unnecessary the separate trial of each of the other individual reclamation claims.

II.

Statement of Salient Facts.

The reclaimant respondent (as well as the other reclaimants whose petitions are similar to that of this respondent) seeks to recover either a fund alleged to have been remitted by the respondent to the bankrupts in trust for a special purpose, or a fund transmitted to the Receiver in bankruptcy by foreign depositaries of the bankrupts, which fund it is claimed had been equitably assigned to the respondent or its predecessor in interest. That claim arises from the following facts:

The bankrupts maintained balances with numerous foreign banks. Thousands of banks throughout the country (hereinafter referred to as inland banks) had no balances abroad, but desired facilities under which such inland banks would be enabled to draw drafts or issue money orders *in their own name* upon foreign banks in which such inland banks maintained no balances. These facilities were supplied to the inland banks by a "drawing service" maintained by the bankrupts.

Under the "drawing service," which in its essentials was similar to that offered to inland banks by various other New York banking institutions, the procedure was substantially as follows:

The inland bank would draw its own draft in a foreign currency upon a foreign bank (in which it had no balance) and would issue that draft to its customer. The name of the bankrupts did not appear on the draft. The inland bank would then advise the bankrupts that it had drawn the draft and would ask the bankrupts to "protect" the draft upon its presentation. Said request was accompanied by a payment to the bankrupts in American dollars calculated at exchange rates furnished daily by the bankrupts. Upon receipt of such request and payment, the bankrupts deposited the money received in their general domestic bank account—in the Trinidad case, the Guaranty Trust Company—and sent written advices by mail to the drawee bank upon which the inland bank had issued its draft. Said advice requested the foreign bank to honor the draft issued by the inland bank "charging same" to the bankrupt's account with that foreign bank.

Immediately upon receipt of said advice and before the presentation of the draft for payment, the foreign drawee bank charged the bankrupt's account for the amount of the draft and credited that amount to an account on its books termed "Drafts Payable." However the testimony showed without contradiction that the bankrupts retained control of the amount so credited and that the foreign bank recognized their right to cancel such advices.

At the time of the filing of the petition in bankruptcy there were outstanding innumerable drafts, thus drawn by inland banks and advised and charged in the "Drafts Payable" account, which had not been presented to the foreign banks for payment by the payees or holders thereof. Immediately upon the appointment of the Receiver the advices of outstanding drafts were cancelled by the Receiver and the balances in the "Drafts Payable" account were eventually remitted to the Trustee.

It is against the fund so returned or against the bank

rupts' balance with the Guaranty Trust Company (which balance was also paid over to the Trustee) that the inland bank, the respondent here, has filed its reclamation claim. That is, the claim was filed on two theories—either that the funds received by the bankrupts from the inland bank and deposited in the Guaranty Trust Company were received in a fiduciary capacity; or that the transaction outlined above resulted in an equitable assignment of the balance which was credited to the "Drafts Payable" account abroad and that that fund, having been returned to the Trustee, can be reclaimed.

The Special Master held that there was neither an initial trust nor an equitable assignment and his decision was confirmed by the District Court. The Circuit Court of Appeals reversed the latter decision and held that there was an equitable assignment of the foreign fund to the holder of the draft by virtue of the bookkeeping entries described above and that the respondent (who is not the payee or subsequent holder but is the inland bank which issued the draft) by taking up the draft became subrogated to the holder's rights. The Circuit Court found it unnecessary to determine whether the payment had been originally received by the bankrupts in a fiduciary capacity.

III

The Contentions of Petitioner—Trustee.

The Petitioner-Trustee contends that the bankrupts—depositors of the foreign bank—at all times remained a creditor of the foreign bank for the amount credited to the "Drafts Payable" account until the draft was presented and paid because they retained control of the amount so credited. This being so it was therefore property which passed to the Trustee under Bankruptcy Act, Section 70-a (3) (5). The bankrupts' only obliga-

tion was to "protect"* the drafts drawn by the inland bank under the drawing service, that is to say, to see to it that the draft was paid upon its presentation. There was no obligation or intention to create or irrevocably appropriate and assign a specific fund *in advance*. In essence, the obligation of the bankrupts under the drawing service was to take care of the draft of the inland bank, just as if it were its own draft. The transaction was the simple ordinary banking transaction—namely, the protection by B of the draft of A—the payment of A's draft from B's credit.

IV.

The Basis of the Court's Decision Contrary to the Uncontradicted Evidence as to History and Purpose of "Drafts Payable" Account.

The Court below referred to a clause in the "drawing service" contract under which the bankrupts agreed that upon their receipt of advice of the drawing of the draft and payment as aforesaid, they would "provide the drawee with funds sufficient for the payment of the draft abroad, by a transfer of credit from our balance or otherwise." It then held that the credit to the "Drafts Payable" account by the foreign bank, when it received the bankrupts' advice, was done in pursuance of the bankrupts' obligation under the foregoing quoted provision, and that it was intended to and did constitute an equitable assignment to the *holder of the draft* of the balance so credited. This conclusion was reached despite the fact that no claim is made that the holder of the draft ever had knowledge of the contract between the bankrupts and the inland bank or indeed of the existence of the bankrupts in the transaction at all, or of the credit to the "Drafts Payable" account.

*Defined in *Wabash R. R. vs. Ham*, 114 U. S., 587, 596.

The Court's conclusion also ignores the uncontradicted evidence relating to the purpose and history of the "Drafts Payable" account, and the intention underlying its use.

It appeared in evidence without contradiction* that the "Drafts Payable" account is an account which has been maintained generally by international bankers, both abroad and in this country and is maintained irrespective of any special contract for its creation. It appeared further that it is the universal custom of international bankers, upon being advised by their depositor of the drawing of a draft (either by the depositor himself or under his protection) forthwith to charge the depositor's account and to credit the amount of said draft to a "Drafts Payable" account. This is an omnibus account to which amounts of all drafts advised by all depositors are credited, irrespective of the nature of the depositor's obligation or the drawee's knowledge thereof. It appeared further that this is a practice of long standing and that there are two reasons for such practice. First, that by making such bookkeeping entries, the drawee bank at all times knows the total of the outstanding demand obligations upon it and can put itself in a position to meet the drafts which had been advised. Second, while the drawee pays interest on the depositor's general balance, it is enabled to use the fund in the "Drafts Payable" account during the period before the presentation of the draft without paying interest thereon as its sole compensation for its services in the transaction. The testimony also showed that despite the bookkeeping entries made as aforesaid, the depositor who has the account in the foreign drawee bank *can cancel the advice* of drafts drawn either by itself or under its protection without obtaining the consent of the payee of the draft or of any other person, and that the foreign

*The evidence appears in detail in the annexed brief at p. 31 hereof.

bank recognizes and obeys only the instructions of its own depositor."

To all of this uncontradicted testimony negativing an intention to treat the credit of the "Drafts Payable" account as an equitable assignment and showing that the balance in the "Draft Payable" account at all times was under the control of the bankrupts, the Court below gave no weight whatever.

V.

The Decision in the Zimmerman & Forshay Case.

That the credit to the "Drafts Payable" account was not made because of the special provisions of the bankrupts' drawing service but in pursuance of the independent international banking practice outlined above is emphasized by a consideration of the facts in *Matter of Zimmerman & Forshay, ex parte Henry G. Gray*, argued and decided below with the case at bar. The opinion in that case appears at p. 13 *post* as Appendix A hereof. There the bankrupts sold to Gray a draft which *they themselves* drew upon a foreign bank with which they maintained a balance. There was no special contract. The draft was advised abroad, charged to the bankrupts' account and credited to a "Drafts Payable" account in the same manner as in the case at bar. The advice was cancelled after the bankruptcy and before the draft was presented and the funds were returned to the Receiver. It appeared also in that case by stipulation that the dealings between the bankrupts and the foreign bank were such that when the bankrupts drew a draft on a foreign bank "and later for any reason wished to stop payment, that a direction to stop such payment would be honored by the bank." Despite the absence of even the semblance

"It is stipulated (fol. 378) that "This [the cancellation by the foreign bank] was done without knowledge on the part of the R. C. I. [the drawee] as to whether such draft or drafts were in the possession of the bankrupts, the drawee banks or third persons."

of a special agreement or of any agreement at all, for the creation of a fund abroad, a majority of the Circuit Court of Appeals held that the claimant was entitled to assert reclamation rights in the balance returned.

VI.

The Fundamental Errors of the Court Below.

The uncontradicted evidence in the present case as to the purpose and history of the "Drafts Payable" account and the fact that in the *Zimmerman* case there was no special agreement between the parties, both prove that the creation and existence of the "Drafts Payable" account in no wise was dependent upon an agreement between the American parties to the transaction. The fundamental error of the Circuit Court, therefore, lies in its conclusion that the credit to the "Drafts Payable" account was an appropriation *in advance of the presentation of the draft* pursuant to the special agreement between the bankrupts and the inland bank, whereas, as just stated, it clearly appeared:

(a) That that credit had nothing whatever to do with the special agreement; and

(b) That in cases where the bankrupts themselves were the drawers of the drafts and had made no special agreement, precisely the same practice was pursued by the drawee bank. That this is so is confirmed by the actual state of facts in the *Zimmerman* case where Zimmerman themselves drew their draft without a special agreement and the drawee bank charged the Zimmerman account and credited the "Drafts Payable", as in the case at bar.

The second underlying error is the Court's interpretation of the uncontradicted testimony as to the history and purpose of the "Drafts Payable" account, and its

failure to give effect to the fact that the foreign bank always recognized the right of the bankrupts to cancel advices prior to the presentation of the draft as is strikingly illustrated by the fact that even after bankruptcy the Receiver's directions were honored by the foreign bank. The *bankrupts* remained creditors of the foreign bank until presentation of the draft.

A third underlying error of the Court below was its conclusion that as a result of the bookkeeping entries abroad there was an equitable assignment in favor of the *payee or subsequent holder* of the draft which could be enforced against the Trustee in bankruptcy. The Court overlooked the elementary principle that an equitable assignment is not absolute but may be revoked by the assignor at any time before the assignee has been notified of the assignment and has expressly or impliedly assented thereto.* As has already been stated, there is no evidence or claim that the holder of the draft (upon which the name of the bankrupts did not appear) at any time had any knowledge of the provisions of the "drawing service", of the creation or existence of the "Drafts Payable" account, or indeed of the existence of the bankrupts themselves. This being so, it is submitted that the Court below erred in failing to hold that the foreign balance was at all times subject to the absolute and sole control of the bankrupts and that accordingly such balances passed to the Trustee under section 70 (3) and (5) of the Bankruptcy Act as "property which prior to the filing of the petition he [the bankrupt] could by any means have transferred * * *."

VII.

Important Reasons Why This Court Should Grant the Writ.

As already stated over two hundred and twenty in-

*See 2 Pomeroy Eq. Jur. (Fourth Ed.) Sec. 1281, post, page 42.

land banks and bankers have filed similar reclamation claims.

Your petitioner submits that the authoritative determination of the questions presented is of the greatest importance to the commercial and banking world for the reason that the banks and banking houses are daily "*protecting*" abroad drafts and checks drawn by their inland correspondents in large number and amounts and are to a similar extent drawing *their own drafts* directly upon their own foreign correspondents. Your petitioner believes that in such transactions all drafts advised to most of the European countries and drafts advised by such European countries to banks in this country are universally charged to the account of the drawer and credited to a "Drafts Payable" account when the advice is received. Your petitioner submits that neither this Court nor any other court in this country has heretofore had occasion to pass upon the effect of these bookkeeping entries nor upon the intention underlying the creation of "Drafts Payable" accounts nor upon the effect of the well established international banking custom giving to the depositor the right to control the credits in the "Drafts Payable" account. Involved in these questions is the further important question: At whose risk the fund is held abroad after the receipt of the advice by the foreign bank and the credit to the "Drafts Payable" account, in the event of the failure of the foreign bank? This case may present for determination the further important question of whether an international banker who receives funds in payment for a draft, either drawn by himself or drawn under his protection, receives such funds in a fiduciary capacity or whether his obligation is purely contractual.

VIII.

Conflict in Decisions.

Your petitioner submits that the decision of the Circuit Court of Appeals interpreting the bookkeeping entires and determining that the setting up of the "Drafts Payable" account was intended to constitute an equitable assignment of that balance is in direct conflict with principles underlying the decisions of the New York Court of Appeals in *Noyes* vs. *First National Bank*, 180 App. Div., 162, affirmed *on opinion below*, 224 N. Y., 542, and the very recent case of *Erb* vs. *Banco di Napoli*, 243 N. Y., 45, and in fact with the decision of the Court below in *In re Interborough Consolidated Corp.* (1923) 288 Fed., 334, certiorari denied 262 U. S., 752, all involving special accounts for the payment of coupons which accounts were there held to be general assets of the estate.

IX.

Wherefore, because of the importance to the banking and commercial community of the question presented and because of the conflict in principle between the decisions of the Circuit Court of Appeals for the Second Circuit and the New York Court of Appeals, your petitioner respectfully prays that a writ of certiorari may be issued out and under the seal of this Court directed to the Judges of the United States Circuit Court of Appeals for the Second Circuit, demanding them to certify and send to this Court a transcript of the record of the proceedings in this case to the end that the decree of said court may be reviewed and that your petitioner may have

such other and further relief in the premises as to this court may seem appropriate.

THE EQUITABLE TRUST COMPANY OF NEW YORK, as Trustee in bankruptcy of Knauth, Nachod & Kuhne.

By SAMUEL ARMSTRONG,
Vice-President.

STATE OF NEW YORK, }
County of New York, } ss.:

SAMUEL ARMSTRONG being duly sworn, deposes and says that he is the Vice-President of The Equitable Trust Company of New York, the petitioner above named; that he has read the foregoing petition and knows the contents thereof and that the same is true to his own knowledge, except as to the matters therein stated to be alleged upon information and belief, and as to those matters he believes it to be true.

SAMUEL ARMSTONG.

Sworn to before me this
27 day of September, 1926.

JOHN E. McGUIRK,
Notary Public, Bronx County,
Certificate filed New York County.

CERTIFICATE OF COUNSEL.

I hereby certify that I have examined the foregoing petition and in my opinion it is well founded and the case is one in which the prayer of the petitioner should be granted by this Court.

GODFREY GOLDMARK,
Counsel.

APPENDIX A.

Opinion in Zimmerman Case.

UNITED STATES CIRCUIT COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

In Re

ZIMMERMAN & FORSHAY,
Bankrupts,

Ex parte

HENRY G. GRAY,
Appellant,

GORDON AUCHINCLOSS, Receiver,
Appellee.

Before: Rogers, Banton and Hand, Circuit Judges.

Appeal from an order of the District Court for the Southern District of New York denying priority to the appellant's claim in bankruptcy.

The bankrupts sold to the appellant a draft drawn upon a Bohemian bank for one hundred thousand Czech crowns. On the same day they credited the drawee with the draft on their books and advised it that they had so drawn. The drawee before petition filed received the advice, charged the face of the draft against the bankrupts' balance on its books, and credited it to another account entitled "drafts payable." The draft was presented and dishonored after petition filed, and the receiver procured a reversal of the credits by the drawee and a remittance of the full balance.

WILLIAM E. SIMS and CHARLES M. KRITZMAN, for the Appellant,

WILLIAM ST. JOHN TOZER for the Appellee.

HAND, Circuit Judge: This is a companion case to In Re Gubelman, ex parte First National Bank of Trinidad, decided herewith. There are some differences in fact: the bankrupts, as drawers, remained generally liable on the draft, and had made no specific contract with the holder (or drawer), to transfer any credit on the drawee's books. Thus the case is somewhat weaker for the petitioner. Nevertheless it appears to us that the skeleton of the transaction is the same. Although it is not so proved, we think that we must assume that when on receipt of the advice the drawee made the entries upon its books, it did so in pursuance of a pre-existing agreement with the drawers. At any rate it is proved that the drawee advised the drawers of what it had done, and there is no evidence that the drawers protested.

Upon that assumption we think that the drawers' advice must be interpreted as a request to the drawee to transfer the credit in the way which it actually adopted. Moreover, when the drawers sold the draft, they promised that it should be paid on presentation (New York Negotiable Instruments Act Sec. 111). Perhaps it is conceivable that the drawee would pay the draft without being then in funds, but banking is not ordinarily done in that way, and we think that the implied agreement of the drawers was that they would, either by remittance or by a transfer of credit, cover the draft before its due date. They chose to transfer the credit and they succeeded, because the drawee had complied with their order before bankruptcy. The prior practice between the drawers and the drawee of stopping payment of such drafts is not shown to have been exercised inimically to outstanding drafts; certainly it was unlawful, if it was.

Order reversed and priority awarded.

Judge Rogers through illness was unable to take part in the decision of this case, but he had provisionally voted for affirmance.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Detailed statement of facts showing the successive steps in the transactions between the parties.

The First National Bank of Trinidad, Colorado (hereinafter referred to as the Trinidad Bank) and numerous other inland banks and bankers maintain no foreign balances, have no foreign correspondents and have no facilities for selling drafts on foreign banks and bankers. In order to enable the inland banks to issue drafts in their own names and perhaps to impress their customers with the facilities which the banks were able to offer, K. N. & K. offered a "drawing service," under which the various inland banks could draw *their own drafts* on foreign correspondents listed by K. N. & K. just as if the inland banks did have foreign correspondents, and K. N. & K. undertook to provide for the payment of such drafts upon their presentation.

In summary, the procedure was as follows:

(1) K. N. & K. sent to their inland bank correspondents, including the Trinidad Bank, daily rate cards fixing the rate for the various foreign currencies (Italian lire in this case) under the drawing service (fols. 70, 434). The rates quoted were "good" only during the day printed on the cards (fol. 434).

(2) Upon the request of its customers in Colorado, the Trinidad Bank would sell *its own draft* on one of the foreign correspondents named in K. N. & K.'s list for the desired amount of foreign currency and would receive payment therefor at the rate fixed in the rate card, plus whatever profit the Trinidad Bank sought to

charge. *The name of K. N. & K. did not appear on the draft.* As far as the inland customer knew, the Trinidad Bank maintained direct relations with the foreign correspondent (fols. 70-72).

(3) Immediately upon the issuance of the draft, the Trinidad Bank would send an advice to K. N. & K. (Claimant's Exhibit 4, p. 161), advising of the drawing of the draft and requesting K. N. & K. "to protect same upon presentation." Remitted with the advice was a sum in American dollars at the rate fixed in the rate card.

(4) Upon receipt of the advice and check, the check was deposited in one of the general checking accounts of K. N. & K., in the Guaranty Trust Company in this case (fol. 74).

(5) Upon the day that the advice was received from the Trinidad Bank, K. N. & K. also sent its advice to the bank upon which the draft had been drawn by the Trinidad Bank, including in such advice all drafts which had been drawn that day on that foreign correspondent of K. N. & K. by all *other* inland banks availing themselves of the "drawing service" and *by K. N. & K. themselves.* All the advices to one foreign correspondent which went forward by one steamer were known as a "Steamer Block" (fol. 75).

(6) The "Steamer Block" was in two parts—(a) one advice to the main office of the foreign drawee, and (b) an individual advice to each branch of the foreign drawee upon which drafts had been drawn that day (fol. 76). The advice to the *main office* of the foreign bank upon which the draft was drawn (the Banca Commerciale Italiana in this case, hereinafter for convenience referred to as B. C. I.) requested the B. C. I. "to *protect* to the debit of our account the drafts as per particulars on

the attached copies." (Claimant's Exhibit 6, p. 163). Attached to the foregoing, were copies of the advices which had been sent to the *branches* of the B. C. I. (Claimant's Exhibits 6A, 6B, 6C, 6D, 6E). The particular draft here involved is found in the advice sent to the Sassari Branch of the B. C. I. (Exhibit 6D). This advice to the branch banks contains the following direction:

> "Please *honor* the above listed drafts charging same to *our* account with Banca Comm. Italiana Genoa."

(7) When the B. C. I. received the above mentioned advices, it thereupon debited the account which K. N. & K. maintained with the bank at its Genoa office to the extent of the aggregate of the drafts, and simultaneously credited on its books an account termed "drafts payable," in which account were also credited amounts of drafts which were advised to the B. C. I. for payment by other depositors or clients of the B. C. I. (fol. 92). Thereafter, no interest was allowed to K. N. & K. or to anyone else upon the amount credited to the account termed "drafts payable," but on the other hand, the B. C. I. received no compensation for its services in honoring drafts except the compensation measured by its use, without the payment of interest, of the money in the drafts payable account (fol. 93).

(8) *All drafts were thus dealt with whether drawn by K. N. & K. themselves or drawn by their inland correspondents* (See Claimant's Exhibit 6A).

(9) *It appears in evidence without contradiction that there is a well recognized banking custom of long standing, under which the foregoing practice is pursued, and that the reasons for the practice are that by making such bookkeeping entries (a) the drawee bank at all times knows of its possible demand obligations and can put it*

self in a position to meet the drafts which have been advised, and (b) as sole compensation for its services in the transaction, it is enabled to use the funds during the interval before the presentment of the drafts without paying interest thereon (fols. 93, 359).

(10) It also appears without contradiction that under the well established banking custom and practice, the American depositor who has an account in the foreign bank *may cancel the advice* of a draft *drawn either by himself or by his inland correspondent*, without obtaining the consent of the payee of the draft or the inland correspondent, and that the foreign bank recognizes and obeys only the orders of its own client without inquiring as to any one's else instructions (fols. 368, 377). K. N. & K. had regular forms for cancelling advices used for both their own and inland bank drafts (Trustee's Exhibits 3 and 4, p. 192 and fol. 383). *Thus it appears that at all times K. N. & K. kept control over their foreign balances and could cancel the advices as they saw fit.*

(11) In the present case, the advice of the Trinidad draft was not cancelled prior to the filing of the petition in bankruptcy, but immediately upon the appointment of the receiver, he cabled to the B. C. I. that he had taken possession of the assets and that all credit balances must be held subject to his order (Claimant's Exhibit 10, fol. 520). Thereafter, the balances in the general account of K. N. & K. with the B. C. I. *and the balances in the drafts payable account* were returned to the receiver by the B. C. I.

(12) *After* the bankruptcy, the draft was presented and payment refused (fol. 330).

Holdings Below.

The Circuit Court of Appeals held that there was an

equitable assignment in favor of the holder of the draft and that the respondent-reclaimant, having taken up the draft, was subrogated to the rights of the holder. The court found it unnecessary to determine whether or not the moneys received by the bankrupts from the Trinidad Bank were received in a fiduciary capacity, or whether, as stated in the contentions of the Trustee below, the relationship was purely contractual and the parties dealt as independent contractors.

Brief of the Argument.

The Trustee contends:

I.

That there was no agreement equitably to assign any funds abroad and that the acts of K. N. & K. after the receipt of the American dollars, did not constitute an equitable assignment; that these acts were done with wholly different intent and solely in pursuance of the banking practice already described.

II.

That an equitable assignment is not absolute but may be revoked by the assignor at any time before the assignee has been notified of the assignment and has expressly or impliedly assented thereto and that until such modification and assent, the foreign balance was at all times subject to the absolute and sole control of the bankrupts, and that, accordingly, such balance passed to the trustee under Section 70 (5) of the Bankruptcy Act as the "property which prior to the filing of the petition, he (the bankrupt) could by any means have transferred • • •."

III.

That under the terms of the drawing service and the forms provided therewith, no trust relationship arose between the Trinidad Bank and K. N. & K. The parties dealt as independent contractors and that the moneys paid to K. N. & K. by the Trinidad Bank were paid for K. N. & K.'s obligation to produce a certain result, namely, the honoring of the draft by B. C. I. upon its presentation. In short K. N. & K. agreed to protect, in the same manner as drafts drawn by themselves, the drafts drawn by the Trinidad or other inland banks.

POINT I.

Neither the contract of the parties nor any of the acts done by K. N. & K. or the B. C. I. after the receipt of the American dollars by K. N. & K. were intended to constitute or did constitute an equitable assignment of K. N. & K.'s balance in the B. C. I. as claimed by the respondent.

Petitioner will

A. State the legal principles applicable to equitable assignments.

B. Indicate what the respondent's contentions are and what their necessary results must be.

C. Show that there was initially no intention or obligation to make an assignment—which will involve an analysis of the contract of the parties.

D. Analyze the acts of K. N. & K. and the B. C. I. after the receipt of the American Dollars by K. N. & K. and show that the acts of both of these parties were not intended to constitute an equitable assignment of any fund in pursuance of any contract, but were done merely in pursuance of well established banking practices under which the credit always remained the property of and under the control and subject to the disposition of K. N. & K. until the presentation and payment of the drafts.

A. Tests of Equitable Assignments.

(1) There can be no equitable assignment of a fund to come into existence unless (*a*) there was an intention to create an assignment; (*b*) such intention has been carried out and a *res* has been set up, the creation of which is carrying out of the intention. Whether or not certain acts amount to the setting up of a *res* is in turn dependent upon the intention with which those acts are done.

Hamer vs. *Sidway* (1891), 124 N. Y., 538.

In re Interboro Consolidated Corporation (C. C. A. 2nd, 1923), 288 Fed., 334-349, where this Court quotes with approval *Hopkinson* vs. *Forster*, as follows: "You can have no charge in equity without an intent to charge."

(2) There can be no equitable assignment unless the assignee consents to the setting up of the fund and agrees to look to that fund *alone* for the performance of the obligation.

Spellman vs. *Banker Trust Company* (C. C. A., 2nd), 1925, 6 Fed. (2nd), 799.

3 *Pomeroy Eq. Jursiprudence* (4th Ed. 1918), Section 1280, says: "The sure criterion is, whether the order of direction to the drawee, if

assented to by him, would create an absolute personal indebtedness payable by him in all events, *or whether it creates an obligation only to make payment out of the particular designated fund.*"

(3) If the fund or balance set up remains at the risk of the alleged assignor, there has been no equitable assignment.

Tiernan vs. *Jackson* (1831), 5 Peters 579, 594;

Williams vs. *Everett* (1811), 14 East, 581, 596.

In re Interboro Consolidated Corporation, 288 Fed., 334-345, quoting with approval Story's Commentaries on Equity, Section 1045, where it is said: "The true test whether an absolute appropriation is made out or not depends upon the point at whose risk the property is; and until the creditor has consented, the property will clearly be at the risk of the assignor or remitter."

(4) If the alleged assignor retains control over the fund or balance or may revoke his instructions with respect thereto, then there has been no equitable assignment.

In *Christmas* vs. *Russell* (1871), 14 Wall. 69, the Supreme Court said at p. 84:

"An agreement to pay out of a particular fund, however clear in its terms, is not an equitable assignment; a covenant in the most solemn form has no greater effect. * * * The assignor must not retain any control over the fund—any authority to collect, or any power of revocation. If he do, it is fatal to the claim of the assignee. The transfer must be of such a character that the fundholder can safely pay and is compellable to do so, though forbidden by the assignor."

In *Cushings* vs. *Chapman* (C. C. Mo., 1902), 115 Fed. 237, the Court said at p. 239:

> "I understand the law to be that a mere promise, however clear or solemn in character, to pay a debt out of a particular fund, does not operate as an equitable assignment of the fund, and especially so when it is a part of a mass of property to be thereafter created. To constitute such an equitable assignment, there must be such an actual or constructive appropriation of the fund or subject matter 'as to confer a complete and present right on the party meant to be provided for, although the circumstances do not admit of its immediate existence'; *that, if the holder of the fund could retain control over it, with the power, sua sponte, on his part, to satisfy the promise in cash, it is fatal to an equitable assignment. Christmas* vs. *Russell*, 14 Wall 69, 20 L. Ed. 762; *Bank* vs. *Beal* (C. C.) 54 Fed. 577; *Badgerow* vs. *Trust Co.* (C. C.) 74 Fed. 925; *Ex parte Tremont Nat. Bank*, 24 Fed. Cas. 184; *Foss* vs. *Cobler*, 105 Iowa, 731, 75 N. W. 516; *Stearns* vs. *Insurance Co.*, 124 Mass. 63, 26 Am. Rep. 617; *Williams* vs. *Ingersoll*, 89 N. Y. 518; *Hicks* vs. *Brick Co.*, 94 Va. 746, 27 S. E. 596; *Hassack* vs. *Graham*, 20 Wash. 192, 55 Pac. 36."

> See also *In re Stiger*, 202 Fed. 791 affirmed (C. C. A. 3rd, 1913), 209 Fed. 148;
> 5 *Corpus Juris*, 913.

The following acts have been held not to indicate an intention to create an assignment:

(1) The mere advice to a bank of the drawing of a draft in accordance with international banking practice does not indicate an intention equitably to assign any of the depositor's balance with the drawee.

> *Eastman Kodak Company* vs. *Park National Bank* (D. C. S. D. N. Y., 1916), 231 Fed., 320 (opinion by Learned Hand, D. J.), affirmed no opinion in this Court, 247 Fed., 1002.

(2) The mere direction to pay a draft and charge it to the account of the depositor does not constitute an equitable assignment nor is there an equitable assignment even if the funds have been placed in the hands of the depositary as a *means* of satisfying the depositor's absolute obligation.

National City Bank vs. *Hotchkiss* (1913) 231 U. S., 50;

Eastman Kodak vs. *Park National Bank* (1916), 231 Fed., 320, aff'd. 247 Fed., 1002;

3 *Pomeroy Eq. Jur.* Sec. 1282, cited with approval in the *Interboro* case, *supra*, at 345, and citing *Cheney* vs. *Libbey*, 134 U. S., 68, 83;

Aetna National Bank vs. *Fourth National Bank* (1871), 46 N. Y., 82, 87.

(3) Even an agreement to pay a debt out of a designated fund does not give an equitable lien on the fund or operate as an equitable assignment thereof.

Williams vs. *Ingersoll* (1882), 89 N. Y., 508;
Christmas vs. *Russell* (1871), 14 Wall, 69.

(4) Mere book entries dividing a bank balance into two or three accounts, as a matter of convenience or in pursuance of a well established custom, do not evidence an intention to assign a fund, and do not constitute an equitable assignment.

In re Interboro Consolidated Corporation, *supra*;

Noyes vs. *First National Bank* (1st Dept. 1917) 180 App. Div., 162, affirmed on opinion below, 224 N. Y., 542;

Taussig vs. *Carnegie Trust Co.* (1st Dept. 1913) 156 App. Div., 519, affirmed no opinion 213 N. Y., 627, and analyzed page 33, *supra;*

Kuehne vs. *Union Trust Company,* (1903), 133 Mich., 602, analyzed page 34, *supra.*

B. The Necessary Results of Respondent's Contentions.

If the respondent's contention that a fund with the B. C. I. was intended to be and was equitably assigned to it by K. N. & K. be sound, the following results would exist under the foregoing authorities:

(1) At the moment the fund was created, (if a "fund" was created) and even prior to the presentation of the inland draft, K. N. & K. was fully discharged.

(2) At the moment the fund was set up, K. N. & K. lost all control over it and the debtor-creditor relationship between B. C. I. and K. N. & K. ceased.

(3) After the fund was set up, it was wholly at the risk of the inland bank; that is, if the B. C. I. in the present case, or if in other cases any one of the hundreds of scattered correspondents named in the list, became insolvent after the fund was set up and before the draft was presented, or for any reason failed or refused to pay the draft upon presentation, the loss would fall, not on K. N. & K., but on the inland banks.

(4) The various steps taken by K. N. & K. would have to be construed as necessarily taken to carry out their previous intention and promise as found in the provisions of the drawing service to create and assign a fund abroad, *despite the fact* (*a*) that no such construction is made when those very same steps are taken in those cases where K. N. & K. issue their own drafts without any such previous promise, and (*b*) that such

steps are taken by international bankers generally in pursuance of well established usage and custom existing for wholly different reasons and irrespective of any special promise.

It will now be shown however, that no such results were intended or effectuated; that K. N. & K. were not discharged until payment of the draft; that K. N. & K. at all times controlled the funds on deposit with B. C. I.; that the risk of loss in the event of the failure of B. C. I. was on K. N. & K. and not on Trinidad; and, finally, that the very steps here taken were the usual and ordinary steps taken in accordance with general international practice and custom, and, indeed, the same steps taken by K. N. & K. in protecting drafts drawn by themselves although no agreement in the nature of the drawing service was entered into with respect to such drafts.

As a result, there is no basis for respondent's contention that funds were equitably assigned in favor of Trinidad or the payee of the draft.

C. Neither the Provisions of the Drawing Service nor the Acts Done in the Performance of K., N. and K's. Obligations were Intended to or Did Constitute an Equitable Assignment.

Having now stated the basic legal principles involved and the necessary results of respondent's contentions, the *contract* of the parties and the *acts* done pursuant thereto will be examined and it will be shown that there was no equitable assignment.

> 1. The provisions of the drawing service and the forms provided for use therewith, do not disclose any intention that any fund should be created or assigned for the payment of the draft drawn by Trinidad on the B. C. I.

An examination of the drawing service and the forms

supplied in connection therewith shows that K. N. & K. was under an absolute contractual obligation to see to it that the draft was paid upon presentation and that they could not be discharged until such payment was accomplished; that is the end which Trinidad desired. It had drawn a draft upon a bank which it did not know—it relied solely upon K. N. & K. and their facilities. Accordingly, K. N. & K. undertook that upon receipt of the advice of the drawing of the draft by Trinidad and the receipt of the consideration in American dollars:

> "We shall promptly forward our advice of the same and provide the drawee with funds sufficient for the payment of the draft abroad by a transfer of credit from our balance, or otherwise" (fol. 422).

What this meant, of course, was that K. N. & K. undertook to notify the foreign bank that the draft had been drawn, and further undertook to see to it that the foreign bank would pay the draft when it was presented. Such payment was to be accomplished by *means* of a transfer from K. N. & K.'s balance, that is, by a debit to the K. N. & K. account, or was to be accomplished "otherwise," which, of course, meant that in those cases where K. N. & K. had no foreign balance in the particular bank, provision would somehow be made by K. N. & K. for having the draft paid—for example by directing a foreign bank with which they did have a balance to arrange for the payment of the draft when presented to the drawee, i. e., to "protect" the draft.

That nothing more than this was intended and that K. N. & K.'s obligation was an absolute and personal one, and not one dischargeable by the creation of a fund, would further appear from the forms, provided with the drawing service, particularly the advice from Trinidad to K. N. & K. that the draft had been drawn (Claimant's Ex. 4, fol. 482). This advice states that Trinidad has

sold the draft in pursuance of the drawing service and states that Trinidad:

> "shall thank you to *protect* same upon presentation."

This direction certainly negatives any idea that K. N. & K. was to discharge their obligation by the creation of a fund.

The phrase "to protect a draft upon presentation" has a well recognized meaning. Such an undertaking is one to see to it that the draft is *paid*. This appears clearly from the case of *Wabash Railroad Co.* vs. *Ham*, 114 U. S., 587, 596. That this was the meaning understood by K. N. & K. is confirmed by the language of the advices which K. N. & K. sent to the B. C. I. (Claimant's Exhibit 6 and 6D). These advices are a clear recognition by K. N. & K. that their obligation was to have the draft honored at presentation to the debit of their account. If the intention had been that K. N. & K. should assign a fund for the payment of the draft in advance of its presentation, then it would have been very easy to provide simply that K. N. & K. should *set up a credit for Trinidad*, so that when the draft was presented Trinidad would have a credit on the B. C. I. books to which the draft could be charged. This is accomplished daily by the ordinary cable or mail transfer. If this had been the intention, the lengthy instructions and provisions of the drawing service would have been unnecessary. But this was not at all the intention of the parties or the scheme of the drawee service. The underlying intention of the service was that the draft should be treated just like a draft K. N. & K. itself had drawn; and just as K. N. & K. would direct the B. C. I. to pay their own drafts, and would, of course, have a balance there at the time of presentation to meet them, so the scheme was to protect the payment of the inland draft by having a balance with the B. C. I. at presentation for its payment, charging it

to the K. N. & K. account. The balance in the form of K. N. & K. credit had to be there at the moment of presentation and not before.

That this was what the parties had in mind is further evidenced by the preliminary statement in the List of Foreign Correspondents (Claimant's Exhibit 1, fol. 418), for there the opening paragraph states that:

> "Inasmuch as the mantenance of a Foreign Department *involving the carrying of balances abroad*, etc., is undesirable from the standpoint of a majority of the inland banks, we have aimed for many years to supply this want by *extending* to our correspondents the privilege of using *our* world-wide facilities for carrying on a foreign exchange business."

It was thus the basic purpose of the drawing service to substitute K. N. & K.'s foreign credit for the necessity of the inland banks having balances abroad; for that was declared to be "undesirable."

Of course, *extending* to the inland correspondents the privilege of using the world-wide facilities *of K. N. & K.* for carrying on a foreign exchange business simply meant that K. N. & K. would make available for the payment of the inland bank drafts *K. N. & K.'s* own balances or credit in foreign countries which K. N. & K. would direct to be charged upon the honoring of the draft (Claimant's Exhibit 6D, fol. 499), when presented. *The scheme here devised was, in its essence, a mere substitute for the purchase by the inland bank of K. N. & K.'s own drafts upon which K. N. & K. would remain liable* despite the *failure of the foreign correspondent.*

It is apparent, therefore, that under the drawing service and the forms used, which together evidence the contract of the parties, there was no intention that any fund should be assigned or appropriated to the payment of the draft. The absence of any such intention *is of*

itself fatal to the contention now advanced (to obtain a preference over other creditors) that any of the balances of K. N. & K. at the time of the filing of the petition in bankruptcy had been equitably assigned.

> 2. The acts done by K. N. & K. and by the B. C. I. in the performance of K. N. & K.'s obligation under the drawing service, including the bookkeeping entries made by the B. C. I. pursuant to a well established international banking custom, are no evidence of an intention to assign or appropriate a fund. This is particularly so, inasmuch as K. N. & K. at all times retained control of their balance and had the right to cancel advices, and thus remained the creditor of B. C. I.

It has just been shown that the contract of the parties did not contemplate an assignment or appropriation of a specific fund abroad. It will now be shown that the *acts* of the parties do not evidence an equitable assignment.

On receipt of the Trinidad bank's check in American dollars (Claimant's Exhibit 3, fol. 481) together with the advice from Trinidad (Claimant's Exhibit 4, fol. 482) K. N. & K. promptly sent an advice to the B. C. I., upon which Trinidad had drawn its draft. Such advice was composed of a statement to the main branch of the B. C. I. at Genoa (Claimant's Exhibit 6, fol. 487) containing a statement of all drafts drawn on the B. C. I. and its branches for a given period and instructing the B. C. I. to "please protect to the debit of our account the drafts as per particulars on the attached copies." The "attached copies" were copies of advices which Knauth, Nachod & Kuhne had sent to each of the individual branches of the B. C. I. upon which drafts had been drawn by them or under their protection (see Claimant's Exhibits 6A-6E, fol. 490, *et seq*). One of such copies (Claimant's Exhibit 6D, fol. 499) was addressed to the Sassari branch of the B. C. I. and included an ad-

vice of the draft here in question drawn by the Trinidad Bank. Such advice reqested the B. C. I. to "please honor the above listed drafts charging same to our account with Banca Comm. Italiana, Genoa."

It is important to note that included in the advice sent to the B. C. I. by K. N. & K., were drafts drawn not only by inland bank correspondents of K. N. & K. (such as Trinidad Bank in this case), but also by "ourselves"—K. N. & K. (See for example, Claimant's Exhibits 6A, fol. 490 aand 6E, fol. 502). *In other words, K. N. & K. took exactly the same steps to protect the drafts drawn by themselves as were taken to protect drafts drawn by their inland correspondents under the drawing service.* It will also be shown that the B. C. I. on receipt of K. N. & K.'s advice acted in the same manner with respect to own drafts and the inland bank drafts. Therefore irrespective of other arguments, if no equitable assignment was contemplated or effected as a result of the issuance of K. N. & K.'s own drafts, none was contemplated or effected as a result of the issuance of the inland bank's drafts including the Trinidad Bank draft in this case.

The Debiting by B. C. I.

Upon the receipt of the advice, the B. C. I. charged the amount of all the drafts, both those issued by various inland banks and those issued by K. N. & K. themselves, to the account which K. N. & K. maintained with the Italian Bank, and

> "simultaneously credited on its books an account termed 'drafts payable' in which account were also credited amounts of drafts advised to the said Banca Commerciale Italiana for payment by other depositors or clients of the Banca Commerciale Italiana in addition to the bankrupts" (fol. 92).

The following facts are to be noted:

(1) That K. N. & K. gave no directions to the B. C. I., to set up a fund which should be irrevocably appropriated to the payment of its own and of the inland drafts, but simply directed them to protect the drafts to the debit of their account and to honor the drafts, charging the same to their account.

2. That while K. N. & K.'s account in the B. C. I. was debited with the aggregate of all the drafts, (*a*) no direction was given to set up the account in favor of the Trinidad Bank, which of course, is what ordinarily is done when a credit is established in favor of somebody by a cable transmission or otherwise; and (*b*) no account was ever set up in favor of the Trinidad Bank.

3. On the contrary all the drafts drawn by all of the depositors of B. C. I. were credited in an omnibus draft payable account, and, as will be shown, the credit in the drafts payable account "is entered in a folio under the name of the bank whose account has been charged" (fol. 350).

Yet, it is from these very acts and circumstances that the respondent urges there must be found an intention equitably to assign a specific fund for the payment of the specific drafts drawn by Trinidad.

Not only is no such intention found by the mere acts themselves, *but on the contrary*, the record shows affirmatively and without contradiction that the entries were made in accordance with well recognized international banking practices and with wholly different intention. The reasons for the existence of the international banking custom, as appears from the testimony of the witness Dawson about to be analyzed are two-fold:

(*a*) That it was a convenient method of indicating to the drawee banker what his commitments were likely

to be in the immediate future and thus enabling him to have liquid and available for immediate use enough capital to meet those commitments;

(*b*) That while the banker paid interest to his depositor on the amount standing to the latter's credit, no interest was paid on the amount of his funds credited to the Unpaid Draft Account and that the use of this latter balance between the time of its credit to the Unpaid Draft Account and the presentment of the draft drawn by the depositor or under his protection without the payment of interest thereon constituted the bank's compensation for its services in meeting the draft.

Testimony of Dawson as to Reasons for Existence of "Drafts Payable Account."

Ralph Dawson, Vice-President of the Guaranty Trust Company, has had extensive experience in international banking for over 25 years (fol. 345), and has had experience in all branches of foreign exchange business (fol. 340 *et seq.*) He has handled foreign exchange transactions, both where the New York banks drew their own drafts upon foreign correspondents (fol. 345) and also is familiar with and has handled transactions involving the "protection of drafts by New York banks, bankers or trust companies on behalf of inland banks" (fol. 346).

At fol. 350 he testified:

> "The Witness.—The practice is to charge the current account of the client with the sum of money and carry it over into another account which is known on the ledgers of most banks as "unpresented drafts drawn," *where it is entered in a folio under the name of the bank whose account has been charged.*"

In other words, although B. C. I. debited K. N. & K.'s general account and credited the unpresented drafts pay-

able account, the credit was entered in a folio, *not* under the name of the Trinidad Bank or the payee, *but under the name of K. N. & K.*, thereby indicating that the balance still belonged to K. N. & K.

And at fol. 350 he was asked this question:

> "Q. Is there also a general practice or custom with respect to the cancellation of advices after their receipt by the foreign bank and prior to the presentation of the draft for payment?"

And at fol. 352, he answered that inquiry as follows:—

> "A. A communication of the fact of cancellation by any means he can avail himself of, cable, letter or anything else. Upon receipt by the drawee bank that such draft has been cancelled, a reversal entry is passed, taking the amount of such cancelled draft from the unpresented draft ledger and crediting it back into the current account."

He was then asked these questions and gave these answers (fol. 353):

> "Q. And does that same custom prevail in the case of drafts drawn by inland banks, where the advice is by the New York bank? * * * A. Yes. * * *
>
> Q. Is such cancellation ordinarily and customarily effected without assigning any reason? * * * A. The drawee bank acts entirely on the orders of its client.
>
> Q. Which is the bank— A. Which is the bank that has the account on its books."

Mr. Dawson made it entirely clear that the same custom obtained in international banking, whether the New York bank had advised its own draft, or the draft of an inland bank, for he testified at fol. 368:

> "Q. You made an answer to Mr. Goldmark to the effect that these cancellations were effected

upon notification from the drawer, didn't you? A. No, sir, from the client.

Q. Then I may have misunderstood you. A. When the question was asked there was no question of a third party.

Q. You mean the person who drew the draft, when you say client? A. No, sir, I mean the name that is on the books of the drawee bank is the client or the owner of the funds.

By Mr. Goldmark:

Q. You mean the person who has the account in the bank? A. Yes, sir.

Q. They cancel the advice at his request whether he is the drawer of the draft or whether he is the person who advised the draft drawn by somebody else? A. Yes, sir, at his order they will cancel the draft."

The reasons for the existence of this custom at the present time were stated by Mr. Dawson to be as follows (fol. 357):

"Q. How has that practice developed in modern times? A. Well, the practice has hung on in modern times, like a great many other practices, and has been availed of as a means frequently of compensating a banker for an account that would otherwise be troublesome and a loss. You have many accounts frequently that are active, which on bare balances in current accounts, are a lot of trouble, and a loss in handling that would not be worth while, but there is always a non-interest bearing float that compensates you for the trouble you take.

Q. So that in reality there are two reasons, are there not, generally assigned, namely, to put the drawee bank or banker in a position to meet the drafts which have been advised, and to enable him to use that fund as he may without paying interest thereon to the person who has the account? A. That is right."

And at fol. 370:

"Q. That is, knowing how much the advised drafts are, you know how much money you have to keep as ready cash? A. Yes.

Q. And you determine the amount of drafts which are to come from your general omnibus drafts payable account? A. Yes.

Q. That is, any day, looking at your drafts payable account, you know how many outstanding advised drafts there are, how much that amounts to, and therefore, you know how much available cash you have to have in order to meet that draft? A. Yes."

And at fol. 373:

"The Master.—And under the present system does the bank have the use of that money until the draft is presented for payment?

The Witness.—Yes.

By Mr. Goldmark:

Q. They can lend it on the street? A. Yes.

Q. That is, they could lend a sum equivalent to some one on the street, so that, at any moment, if the number of drafts which had been advised, which came in on a particular day, was more than the average number that came in on another day, you would always know at the beginning of the day how much money you needed from your drafts payable account to meet outstanding drafts? A. Yes."

In addition to explaining the present practices and the reasons underlying them, Mr. Dawson testified as to the origin of these practices. He stated, in substance, that in the past when there were no Federal reserve banks, banks of rediscount or methods of suddenly raising cash, an international banker on being advised that his depositors had drawn drafts on him, would convert some of *his own* non-liquid assets into cash and hold the cash ready to meet the obligation, namely, the payment of the drafts which his depositor had drawn. He even went

so far in ancient times, Mr. Dawson believes, as to set aside his own cash in separate bags to meet separate drafts, the drawing of which had been advised. The repondent apparently seeks to attach much weight to this belief of Mr. Dawson as to the historical origin of the present custom and seeks to find therein conclusive proof of an intention equitably to assign a particular fund for the payment of a draft not yet presented.

Of course, the fallacy of the respondent's contention is obvious and is this:

The bankers in early days who are said to have set aside cash to meet advised drafts were not setting aside cash which belonged to their depositors, but *their own cash*, so that *they* would be in "possession of funds to meet their commitments" (fol. 356).

The depositor who was the drawer of the draft and the creditors of the bankers did not set aside any moneys which belonged to him. He had no intention of appropriating any specific fund to the payment of his advised draft. All he desired was that the draft should be paid upon its presentment. Of course, he had no objection or right to object if the banker in those days saw fit to liquidate his own securities in order to provide *himself* with the cash to meet the obligation. But the controlling fact is that the depositor, the drawer of the draft, always had the right to cancel the advice and therefore his acquiescence in the banker's setting aside his, the banker's own money, in no wise affected the rights of the depositor or irrevocably appropriated the depositor's money. The depositor remained the creditor of the banker until the draft was paid.

Accordingly, it is impossible, even out of this ancient practice, to spell out an intention on the part of the depositor equitably to assign or appropriate any money for the payment of the advised drafts.

As will be shown, the reservation of the right of can

cellation and the maintenance of control over the debt from the bankers to the depositor is fatal to any theory of equitable assignment.

Certainly the uniform modern practice is no more than a banking convenience, which has grown up for the reasons so clearly stated by Mr. Dawson.

As testified by Mr. Dawson, who was familiar with and had done the same kind of business (fol. 346), the practice exists with respect to all advised drafts, whether they are drawn by the American depositor himself or drawn by an inland bank under protection of the American depositor. Certainly, in the light of this well recognized banking practice, it is impossible to urge that K. N. & K. by approving of the debit thereby intended equitably to assign a part of their foreign balance. How common the practice was to cancel any and all drafts without knowledge or consent of the inland bank appears from the fact that K. N. & K. had printed forms which they used to accomplish this result (Trustee's Exhibit 3 and 4, p. 192).

The direction contained in Trustee's Exhibit 3 to cancel an advice was given without the consent of the inland bank or of the payee of the draft, even when it was not known in whose possession the draft was. Such direction was honored by the B. C. I. because at all times the B. C. I. considered itself obligated only to K. N. & K. and recognized no obligation either to Trinidad or to the payee. The reason for this was clearly stated by Mr. Dawson in his testimony at fol. 368, already quoted, where he says that the bank only recognizes the instructions of its own depositor, whether that is the drawer of the draft or whether it is the person who advised the draft drawn by somebody else.

Other Evidence Confirming Dawson's Testimony as to Custom.

The existence of the international banking practice to which Mr. Dawson testified is also confirmed by the testimony of Mr. Schulze (fol. 327). On this phase of the question it is important also to note Mr. Schulze's testimony (fols. 400 to 402), that in cases where dollar drafts were drawn on the B. C. I. (as distinguished from drafts drawn in lire as in the case at bar), the amount thereof was not charged against K. N. & K.'s general account on receipt of the advice and was not credited to the Drafts Payable Account, and that, therefore, inasmuch as the B. C. I. had the use of no credit without the payment of interest pending the presentation of the draft, it received a commission for honoring these dollar drafts. The application of the general custom testified to by Mr. Dawson, under which the B. C. I. looked only to its customer, K. N. & K., for instructions as to cancellation and recognized K. N. & K.'s sole control over their balances both in their general account and in the Drafts Payable account, is confirmed by the testimony of Mr. Schulze (fols. 216-219 and 234-238). The absolute control of K. N. & K. over their balance with the B. C. I. has been clearly demonstrated.

Mr. Dawson's testimony is also supported by the facts *stipulated* at fol. 378 to the effect that the B. C. I. cancelled drafts drawn either by K. N. & K. or under their protection and that

> "This was done without knowledge on the part of the B. C. I. as to whether such draft or drafts were in the possession of the bankrupts, the drawer banks or third persons."

D. The Conclusions from the Foregoing Facts Show that the Tests of the Existence of Equitable Assignment Have Not Been Met.

The foregoing facts establish the following propositions:

(1) There was no intention on the part of K. N. & K. or the Trinidad Bank to assign any funds abroad, K. N. & K.'s sole obligation being to have the draft paid at presentment, as in the case of drafts drawn by K. N. & K. themselves and thus see to it that Trinidad's obligation to its customer and the payee was performed. K. N. & K. agreed to furnish sufficient funds as a *means* of enabling them to perform their obligation.

(2) K. N. & K. did not direct B. C. I. to set up any particular fund but simply directed the debiting of the drafts to their general account upon presentation. And no fund was in fact set up in favor of Trinidad or irrevocably appropriated abroad. The credit to the omnibus "drafts payable" account was made, not in pursuance of K. N. & K.'s obligation under the drawing service, but pursuant to the well established international banking custom. The same practice was pursued with respect to drafts drawn by K. N. & K. themselves, although their issuance was not governed by the terms and conditions of the drawing service. This custom exists for reasons entirely independent of a desire irrevocably to create a fund.

(3) The Trinidad Bank did not agree to look to the fund abroad for the payment of the draft drawn by it, but desired and procured K. N. & K.'s general obligation "to protect" that draft when presented. *Does the respondent seriously argue that the intention underlying the drawing service as agreed to by the parties was that the large and small banks scattered throughout this country who*

had no knowledge of foreign banks and bankers, were paying over their money to K. N. & K., relying on the credit, solvency and responsibility of foreign correspondents in scattered communities throughout Europe, wholly unknown to them and chosen by K. N. & K.? What the inland banks wanted was that their drafts drawn upon foreign bankers with whom they had no relations whatever and of whom they knew nothing, be honored. They did not want funds set up in innumerable places throughout Europe which would be there at their risk, awaiting the presentation of the drafts. If the reverse were true, every bank throughout the country which availed itself of the service of K. N. & K. or other New York bankers, affording a like service, would have to look solely to the foreign bank, and in the event of its failure or refusal to pay, loss would not fall on K. N. & K., but on the inland banks.

(4) The balance with the B. C. I. was at all times at the risk of K. N. & K., inasmuch as they had assumed an absolute obligation to have the drafts paid on presentment, from which obligation they would not have been relived by the failure of the B. C. I., with the consequent loss of the balance.

(5) It appears from undisputed testimony of Mr. Dawson and Mr. Schulze and from the stipulations in the record (fol. 378) just referred to that both that portion of the balance standing to K. N. & K.'s credit on the books of B. C. I. and that portion credited in the drafts payable account, was at all times at the absolute control and disposition of K. N. & K. and that the B. C. I. looked only to K. N. & K. for instructions as to the disposition of both balances. That is, K. N. & K. always remained the creditor of B. C. I.

POINT II.

Because of the International Banking Practice and because the holder of the draft (to whose rights the Court below held the respondent subrogated) had no notice of the alleged assignment and did not consent thereto, any alleged assignment was revocable and the balance assigned remained subject to the bankrupt's control, and, accordingly was property which passed to the trustee under Section 70a (3) and (5) of the Bankruptcy Act.

In 3 *Pomeroy Eq. Jur.* (4th Ed.), Sec. 1281, the learned author says:

> "*Notice to the Creditor-Assignee Essential.* Although, whenever a debtor, in the manner above described, makes to his creditor an equitable assignment of a specific fund or debt in the hands of or owing by a third person, the assent of such third person is not requisite to the effect of the transfer in equity, yet the assignment, appropriation, direction, or order is not absolute, but may be revoked by the debtor-assignor at any time before the creditor-assignee has been notified of it, and has expressly or impliedly assented thereto. In such a case notice to and assent by the creditor-assignee are essential to an absolute assignment."

This statement of the law is supported by numerous authorities, which it is unnecessary to consider in detail at this time.

As the bankrupts, both for the foregoing reason and because of the international banking practice already discussed, kept control of the fund, the balance credited to the drafts payable account passed to the Trustee in

bankruptcy under the following provisions of Section 70 of the Bankruptcy Act:

> "(a) The trustee of the estate of a bankrupt, upon his appointment and qualification, and his successor or successors, if he shall have one or more, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt * * * to all * * * (3) powers which he might have exercised for his own benefit, but not those which he might have exercised for some other person; * * * (5) property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him * * *."

POINT III.

There initially was no trust relationship and the parties dealt as independent contractors.

In view of the fact that the Circuit Court of Appeals has found it unnecessary to pass upon this extremely important question, it will not be discussed at length at this time. In support, however, of the contention that there initially was no trust and that the parties were merely dealing as independent contractors, petitioner begs leave to refer to the following authorities:

That there was initially no trust relationship:

Legniti vs. *Mechanics & Metals N. B.* (1921) 230 N. Y., 415;

Beecher vs. *Cosmopolitan Trust Co.* (1921) 239 Mass., 48;

Gravenhorst vs. *Zimmerman & Forshay* (1923) 236 N. Y., 22;
Samuels vs. *E. F. Drew & Co., Inc.* (C. C. A. 2nd, 1924) 296 Fed., 882.

That the parties dealt as independent contractors and not as principal and agent:

Casement vs. *Brown* (1893) 148 U. S., 615;
Sloan Shipyards Corporation vs. *Fleet Corporation* (1922) 258 U. S., 549.

POINT IV.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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